BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Commission, on its own motion, to make adjustments to the universal service fund mechanism established in NUSF-26.	))))	Application No. NUSF-50 Progression Order No. 1

Comments of
The Rural Independent Companies

Executive Summary

The Rural Independent Companies (the "Companies") urge the Nebraska Public Service Commission (the "Commission") to refrain from making changes to the permanent Nebraska Universal Service Fund ("NUSF") support mechanism so soon after the permanent mechanism has been implemented. The permanent NUSF support mechanism has been in effect for only fifteen months. Changing the mechanism after such a short period of operation would make the mechanism unpredictable. Both the Nebraska Telecommunications Universal Service Fund Act ("NTUSF Act") and the goals for the permanent NUSF support mechanism established by the Commission specify that support mechanisms should be predictable. If the NUSF support mechanism is unpredictable, it will greatly decrease the incentives for network investments, as carriers will be reluctant to maintain and upgrade their networks if they do not have a reasonable expectation that they can recover a portion of such investments through NUSF support. This is especially true if it appears that changes in the support mechanism may reduce the amount of support received by Nebraska Eligible Telecommunications Carriers ("NETCs") relative to the amount of support such carriers currently receive.

The NTUSF Act and the Commission's goals for the permanent NUSF support mechanism also state that support should be sufficient. The Commission has found that the current amount of support distributed is sufficient; therefore, a significant reduction in the amount of NUSF support distributed would likely result in the permanent NUSF support mechanism distributing insufficient support.

In the event that the Commission reduces the amount of NUSF support distributed, the Companies recommend that the reduction be implemented by gradually reducing the amount of the per-line backstop and over-earnings redistribution ("OER") transitional mechanisms. These mechanisms were designed to allow carriers to adjust to the receipt of reduced support amounts and were to last for a period of five years. The gradual reduction of support paid through these transitional mechanisms would merely accelerate a process that was already planned.

The Commission should not cut the size of the base support allocation. When the Commission established the permanent NUSF support mechanism it indicated that the mechanism "highly targets support to the most costly and sparsely populated out-of-town service areas where NUSF support is needed." Cutting the base support allocation, while allowing the transitional mechanisms described above to remain in place, would effectively eliminate the careful targeting of support for which the mechanism was designed.

In the event that the Commission reduces the amount of NUSF support distributed, the Commission should establish a rebuttable presumption that carriers experiencing decreased NUSF support amounts should be allowed to increase their intrastate access rates to generate revenue equal to the reduction in NUSF support. Commission precedent with regard to allowing carriers to raise their intrastate access rates following a reduction in NUSF support, as well as federal and state statutes that indicate that state support may be implicit, support the replacement of NUSF support with support in the form of increased access rates if NUSF support is reduced.

The Commission should not lower the rate-of-return ("ROR") cap in order to attempt to reduce NUSF distributions. Unlike the federal ROR that establishes a guaranteed ROR, the Commission's ROR cap sets the maximum amount that carriers may earn, and carriers may earn far less than the maximum. Therefore, it is appropriate that the ROR cap should be somewhat greater than the federal ROR, because the cap limits, but does not guarantee, a given level of earnings. The current ROR cap of 12 percent is somewhat greater than the federal ROR of 11.25 percent, which was recently examined and reaffirmed by the Federal Communications Commission ("FCC"). The current ROR cap is appropriate and the level of the ROR cap is supported by the FCC's recent findings that the federal ROR is appropriate.

The Companies submit that the Commission should conduct another proceeding outlining proposed changes to the permanent NUSF support mechanism prior to making any changes to NUSF support amounts. Due to the interdependence of several components of the NUSF support mechanism, the impact of making several changes to the support mechanism simultaneously cannot be determined without specific proposals. Furthermore, additional clarification of the manner in which some NUSF model components are intended to be applied is necessary.

I. Introduction

The Companies submit their comments in response to the Commission's Progression Order No. 1 (the "Order") entered in this proceeding. The Commission opened this docket to consider certain adjustments to the permanent universal service fund mechanism established in the NUSF-26 docket. In the Order, the Commission seeks comments on various issues relating to whether the NUSF mechanism should be modified in light of the Commission's previous decision to reduce the NUSF surcharge from 6.95 percent to 5.75 percent of intrastate retail revenues on telecommunications services.[1] The Companies appreciate the opportunity to provide these comments and participate in this important proceeding.

The comments offered in this proceeding regarding the general policy implications of proposed changes to the permanent NUSF support mechanism on which the Commission seeks comment. The Companies submit that the Commission should conduct another proceeding outlining proposed changes to the permanent NUSF support mechanism prior to possibly making any changes to NUSF support amounts. Due to the interdependence of several components of the NUSF support mechanism, the impact of making several changes to the support mechanism simultaneously cannot be determined without specific proposals. Furthermore, additional clarification of the manner in which some NUSF model components are intended to be applied is necessary. For example, are carriers eligible to receive support under the per-line backstop and over-earnings redistribution ("OER") transitional mechanisms only if the amount of NUSF support they received during the first year of operation of the permanent NUSF mechanism (2005)

[1] *See Order* at ¶ 2.

was less than the amount of support they received immediately prior to the institution of the permanent NUSF support mechanism? Or, are all carriers eligible to receive support under the aforementioned transitional mechanisms if they experience a reduction in permanent NUSF support during a year other than 2005 relative to the amount they received immediately prior to the institution of the permanent NUSF support mechanism? Answers to questions such as these regarding the operation of the permanent NUSF mechanism are critical in order to provide informed responses to Commission proposals to reduce the amount of NUSF support distributed.

II. Potential Changes In NUSF Support Should Be Examined To Ensure Consistency With Historical NUSF Policy And The Goals Of The NUSF.

In order to properly analyze any potential changes to high-cost support raised in the Order, it is necessary to review the history of the mechanisms that have provided revenues to support universal service in rural, high-cost areas. The Commission provided a general history of universal service policy and its rationale for establishing the NUSF in its January 13, 1999 Order in Application No. C-1628.[2] The Commission stated:

> In the past, universal service has been funded through a conscious policy of pricing certain incumbent local exchange carriers' (ILEC) services such as access service, toll service and local business service at levels that support primarily residential service. The "implicit subsidies" contained in charges are and have been used to keep local residential exchange rates affordable for all subscribers. This policy was adopted by both federal and state regulators and implemented by the telecommunications industry.[3]
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> Due to the opening of ILEC markets to competition, this subsidization practice is no longer desirable. As a result, the *rates for services that provide implicit support should be reduced. The lost support may, over a reasonable period of*

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[2] *See The Nebraska Public Service Commission, on its own motion, seeking to conduct an investigation into intrastate access charge reform*, Application No. C-1628, Findings and Conclusions (*"C-1628 Order"*) (entered Jan. 13, 1999).

[3] Id. at p. 2.

time, be replaced through increases in rates and by state and federal universal service funds.[4] (emphasis added)

. . . .

A change of this magnitude takes time and a concerted effort on behalf of all parties involved. Therefore, *the Commission proposes a transition period for adoption of the goals addressed in this order.*[5] (emphasis added)

After establishing the NUSF and a transitional mechanism to provide support for revenues lost through rebalancing of rates, the Commission initiated a proceeding to adopt a permanent NUSF support mechanism.[6] The Commission adopted a list of goals for the permanent mechanism. The goals that the Companies believe are pertinent to this proceeding are as follows:

a) The Commission should establish *sufficient specific and predictable state support mechanisms.*
b) All providers should be afforded an opportunity and not a guarantee to recover their costs. Support should be used for its intended purpose and any support that comes directly from the NUSF should be explicit.
c) The Commission should ensure that *all Nebraskans have comparable access to quality telecommunications and information services, including interexchange services, advanced telecommunications and information services.*
d) *All services must be offered at rates that are just, reasonable and affordable, and that rural rates should be reasonably comparable to urban rates, all across the services.*
e) *The Commission should* encourage the development and maintenance of the telecommunications infrastructure and *encourage investment and the deployment of new technologies.*[7] (emphasis added)

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[4] Ibid.

[5] *See C-1628 Order* at p. 3. The length of the transition period was set at three years for non-rural carriers and four years for rural telephone companies (*see* Id. at p. 8).

[6] *See The Nebraska Public Service Commission, on its own motion, seeking to establish a long-term universal service funding mechanism*, Application No. NUSF-26, Order Initiating Docket (entered Aug. 21, 2001).

[7] *See The Nebraska Public Service Commission, on its own motion, seeking to establish a long-term universal service funding mechanism*, Application No. NUSF-26, Progression Order No. 2 (*"NUSF-26 Goals Order"*) (entered Aug. 27, 2002) at ¶ 29.

The Commission adopted a permanent methodology to distribute NUSF support in a November 3, 2004 order in Application No. NUSF-26. The Commission found that:

> The proposed *methodology highly targets support to the most costly and sparsely populated out-of-town service areas where NUSF support is needed.* The methodology specifically pinpoints the support areas and provides companies with a specific model for determining the amount of support available for distribution.[8] (emphasis added)

As in Application No. C-1628, the Commission found in NUSF-26 that a transition period of several years would allow carriers to adjust to the permanent support mechanism and would be in the interest of consumers:

> *The Commission adopts the proposed transition mechanism* to accompany the permanent funding mechanism. The Per-Line Backstop and Over-Earnings Redistribution are *for a period of five years, whereas NUSF-7 sunsets when the investment made by the company is fully depreciated. The Commission finds this transition period allows carriers an opportunity to make adjustments, prevents undue hardship to customers and is in the public interest.*[9] (emphasis added)
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> . . . .
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> As companies invest additional monies into their networks, those at or above the earnings cap will see a decrease in their respective rate-of-return. As such, additional SAM support amounts will begin to flow back to those companies. Thus, as a company invests and stakes claim to its SAM support amounts, OER monies available will gradually decrease. The Commission finds this to be a reasonable and viable transitional mechanism.[10]
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> *The Commission encourages companies to utilize this transition period to accomplish investments necessary to further the goals of the Fund.*[11] (emphasis added)

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[8] *See The Nebraska Public Service Commission, on its own motion, seeking to establish a long-term universal service funding mechanism*, Application No. NUSF-26, Findings and Conclusions (*"NUSF-26 Permanent Methodology Order"*) (entered Nov. 3, 2004) at ¶ 11.

[9] Id. at ¶ 62.

[10] Id. at ¶ 75.

[11] Id. at ¶ 76.

The Companies believe that this history of the NUSF highlights two overarching principles that should be remembered when considering changes to the permanent NUSF mechanism. One principle is that the NUSF has replaced implicit support contained in rates with explicit support paid from the NUSF in order to allow rates that are more conducive to a competitive marketplace, while maintaining affordable rates and reasonably comparable rates and services for all subscribers of supported telecommunications services. If explicit NUSF support is reduced, it is likely that affordable rates and reasonably comparable rates and service offerings may not be available to all subscribers of telecommunications services, unless the lost explicit support is replaced with implicit support.

A second overarching principle of the NUSF has been to encourage investment, especially by adopting distribution mechanisms that are to remain in place for a period of several years. The original NUSF distribution mechanism was used to distribute support for a period of about five years, which was somewhat longer than the timeframe initially specified in the *C-1628 Order*.[12] Meanwhile, the Commission specified in the *NUSF-26 Permanent Methodology Order* that the transition mechanisms accompanying the permanent funding mechanism would last for a period of five years. Network assets have depreciable lives of greater than five years, as recognized by the Commission in allowing NUSF-7 waiver grants to continue until the network investments supported by the grants have been fully depreciated.[13] Therefore, even guaranteeing that a given mechanism will be used for a period of five years does not guarantee that a carrier will recover its costs

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[12] *See* footnote 4.

[13] Id. at ¶ 62.

associated with a given investment. However, making changes to the NUSF distribution mechanism, such that support amounts are substantively changed, would decrease incentives for investment in the very areas to which the Commission has targeted support, those areas being high-cost and sparsely populated rural areas.[14]

Incentives for investment would be decreased because the predictability of support would be greatly reduced. If carriers do not have a reasonable expectation that they will receive, from various revenue sources, sufficient funds to recover the cost of network investments, carriers are unlikely to make network investments. Furthermore, the decreased incentives for investment would diminish the likelihood that NUSF goals will be attained. Specifically, it could interfere with all Nebraskans having comparable access to quality telecommunications and information services, including interexchange services, advanced telecommunications and information services, and it could deter the deployment of new technologies.

In addition to being contrary to the overarching principles of the NUSF identified above, some of the changes being proposed appear to violate the principles found in the Commission's NUSF goals that support should be predictable and sufficient, as required by Nebraska statute, which also says that support should be predictable and sufficient.[15] NETCs have already begun to rely upon previous Commission orders, including the *NUSF-26 Permanent Methodology Order*, in making appropriate business decisions regarding capital and expense planning for high-cost areas. As discussed above, the Commission announced that the transition period for the permanent mechanism would be

[14] Id. at ¶ 11.

[15] *See* Neb. Rev. Stat. § 86.323(5).

five years, and the Commission encouraged carriers to make new investments in high-cost areas in reliance upon the permanent mechanism. Consequently, if the Commission now reduced NUSF support to a carrier, less than 15 months since the implementation of the permanent mechanism, it would appear that the NUSF support mechanism could be characterized as unpredictable. This type of sudden change would seriously harm carriers that have made or planned investments based upon the Commission's orders.

III. The Commission Should Not Reduce The Size Of The Base Support Allocation.

The Commission asks several questions regarding a reduction to the base support allocation and the implementation of such a reduction.[16] The Companies believe that the Commission should not reduce the base support allocation. The current base support allocation is approximately equal to the total amount of support paid under the transitional mechanism in 2004.[17] This total removed and converted amounts identified by the Commission as implicit subsidies into explicit NUSF support. As discussed above, when the Commission established the NUSF, it found that certain services provided by ILECs, including access, toll and local business service, had been priced at a level that supported local residential exchange rates.[18] Due to the opening of ILEC markets to competition, the Commission found the practice of providing "implicit subsidies" to no longer be desirable. Rather, it found that rates for residential basic local exchange service should be increased, and explicit state universal service support should

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[16] *See Order* at ¶ 4.

[17] According to the data provided in the Excel file "Year2_NUSF_26_Distribution_05_12_20_PublicVersion.xls," NUSF support paid to NETCs in 2004 totaled $66,929,834, the base support allocation for 2006 is $66,500,000, and the Total NUSF Support to be provided to NETCs during 2006 is $71,768,381.

[18] *See C-1628 Order* at p. 2.

be provided to replace implicit support.[19] If the Commission were to reduce the base support allocation, it would reduce the explicit support available to carriers, which would likely necessitate an increase in access and toll rates, as explained in more detail later in these comments. This would be contrary to a Commission policy that has been in effect for more than seven years and is still warranted, given that the circumstance that led the Commission to adopt the policy of removing implicit subsidies – that is, the opening of ILEC markets to competition – is still the state's goal today. Therefore, the Companies believe that it is inappropriate to cut the base support allocation.

In addition to the Companies' belief that it is inappropriate to cut the base support allocation on policy grounds, reducing the base support allocation would not be a "fair and balanced approach;" instead, it would unfairly impact certain carriers.[20] To illustrate, the Companies simulated the result of reducing the base support allocation a total of $12 million. A $12 million reduction in the base support amount would not be evenly distributed among carriers; in other words, the reduction would not be distributed proportionally among carriers based on the current NUSF support amount each carrier currently receives. In general, the majority of carriers would experience no reduction in NUSF support. However, those carriers experiencing a reduction in NUSF support would generally experience a decrease in the range of approximately 15 to 22 percent. This would be a greater reduction than the 13.3 percent reduction in the total amount of support that would be paid to all carriers combined.[21] Such an unjust result clearly

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[19] Ibid.

[20] *See Order* at ¶ 4.

[21] The proportional reduction in the total amount of support distributed is computed as $9.5 million/$71.8 million.

eliminates incentives for carriers to invest in their networks as requested by the Commission in the *NUSF-26 Permanent Methodology Order* and appears to be contrary to many of the Commission's universal service goals as discussed above.

The Commission also asks whether the funds distributed would remain sufficient if the total amount of support allocated is reduced.[22] The Commission has previously found that the current base support amount is a sufficient amount. Specifically stated, "the Commission finds the baseline support allocation is sufficient."[23] Therefore, since the current total base amount of support has been determined to be sufficient, a significant reduction of this amount would cause a substantial likelihood that the support amounts for some or all of the carriers receiving support may be determined to be insufficient.

IV. The Transitional Mechanisms Should Be Modified If The Commission Wishes To Reduce The Total Amount Of NUSF Support Distributed.

When the Commission adopted the permanent NUSF support mechanism, it also adopted a set of transitional mechanisms that would allow carriers that were to receive decreased support under the permanent mechanism to make adjustments to the decreased support level.[24] The per-line backstop and OER transitional mechanisms were adopted for a period of five years, while the NUSF-7 grants were to continue until investments made by a carrier under such a grant were fully depreciated.[25] While the Companies do not believe that it is appropriate to reduce the amount of NUSF support distributed as

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[22] *See Order* at ¶ 4.

[23] *See NUSF-26 Permanent Methodology Order* at ¶ 12.

[24] Id. at ¶¶ 62-63.

[25] Id. at ¶ 62.

discussed above, in the event that the Commission reduces the amount of NUSF support distributed, it should accomplish this reduction by gradually reducing the amount of support for which carriers may be eligible through the per-line backstop and OER transitional mechanisms – since those mechanisms were transitional in the first place, not permanent.

Instead of distributing the entire amount of funds for which carriers are eligible under the per-line backstop and OER mechanisms, the Commission could proportionally reduce the amounts for which carriers are eligible in years two through five of the transitional mechanism.[26] For example, the Commission could reduce the amount of per-line backstop and OER support for which carriers are eligible by twenty percent per year. If the Commission were to reduce per-line backstop and OER support in this manner, carriers that are eligible for such support would receive 80 percent of the per-line backstop and OER support for which they are eligible in 2006, 60 percent of the per-line backstop and OER support for which they eligible in 2007, and so on through the end of the transitional mechanism in 2009. The Companies offer the forgoing example for illustrative purposes only, and are not suggesting that a twenty percent per year reduction is the appropriate amount by which per-line backstop and OER support should be reduced each year for the remainder of the transitional mechanism.

Gradually reducing the amount of support for which carriers are eligible through the transitional mechanism would affect a far smaller number of carriers than would other changes to the permanent NUSF support mechanism such as reducing the base allocation amount. For example, only five carriers will receive per-line backstop and/or OER

[26] Calendar years 2006 through 2009.

support in 2006. Of these carriers, only one carrier, Qwest, receives more than 12 percent of its total NUSF support through the per-line backstop and OER transitional support mechanisms. Furthermore, the Commission has determined that carriers receiving per-line backstop and OER support will cease to do so at the end of the transitional period; therefore, carriers receiving such support should already be planning for the elimination of such support in less than four years. In addition, the amount of funds available for OER may decrease over the remainder of the transitional period, as carriers which are currently receiving less than their total SAM distribution amount due to overearnings may make additional investments, which have been encouraged by the Commission, and thus be eligible to receive additional NUSF support, lowering the amount of overearnings available for distribution through OER.

The Companies do not view gradually reducing the amount of support paid through the per-line backstop and OER transitional mechanisms as being "an easy short term fix" as suggested in the Order.[27] Rather, it would merely be accelerating a process that was already planned, and in fact is occurring as we speak. To the extent carriers that do not receive their entire NUSF support allocation due to overearnings are not able to make sufficient investments so that they may receive their entire allocation, a reduction in NUSF support that is distributed through the per-line backstop and OER would reduce the total amount of funds required for NUSF. For example, in 2006, $19 million is being distributed through the per-line backstop and OER mechanisms. If the Commission were to reduce the amount of funds distributed through per-line backstop and OER to eighty percent of the amount for which carriers are eligible in 2006, the total amount of funds

[27] *See Order* at ¶ 9.

distributed in 2006 would be reduced by slightly more than $8 million. Such a change is far more appropriate – and consistent with the NUSF orders and state law – than reducing the base support allocation.

Indeed, it appears that the Commission has already incorporated a mechanism into the model that would allow it to reduce the earnings cap on potential receipt of per-line backstop and OER transitional mechanism support. However, there may be other ways in which the model can be modified to allow for the gradual reduction of support distributed through the per-line backstop and OER transitional mechanisms. In the event the Commission determines that NUSF support distributed should be reduced, the Companies encourage the Commission to first consider and thoroughly examine potential changes to the per-line backstop and OER transitional mechanisms in order to determine the most appropriate manner to gradually reduce NUSF support distributed through these mechanisms.

V. The Commission Should Allow Carriers To Increase Their Access Rates If NUSF Support Amounts Are Reduced.

In the event that the Commission reduces NUSF support amounts, the Companies believe that it would be appropriate to allow carriers to increase their access rates in order to recover lost revenues. In Application No. C-1628, the Commission found at the time that certain services provided by ILECs, including access, had been priced at a level that supported local residential exchange rates.[28] Thus, the Commission found that explicit state universal service support should be provided to replace implicit support provided by access and other ILEC services.[29] However, in the event that the Commission reduces

[28] *See C-1628 Order* at p. 2.

[29] Ibid.

the level of explicit state universal service support, the explicit support must be replaced in order to maintain sufficient support for achieving universal service requirements.

The Commission has already established a precedent for such action by allowing an increase in intrastate access rates following a reduction in the payment of NUSF support. Qwest increased its intrastate access rates in a December 20, 2004 access tariff rate filing based, at least in part, on an alleged reduction in NUSF support.[30] Following a Commission investigation of the increase,[31] the Commission approved a rate increase that doubled the previous rates.[32] Based on this action, it would appear that the Commission recognizes the need to replace a reduction in NUSF support with support through means such as an increase in intrastate access rates.

The Commission has also indicated that access rate increases may be necessary for rural companies if NUSF support is reduced. In Application No. NUSF-28, a proceeding that examined intrastate access charges for rural ILECs, the Commission's findings stated that:

> The rural independent carriers expressed the concern that shifting cost recovery to explicit universal service support may not give them the predictability as required in Neb. Rev. Stat. § 86-1404(5). Their concern is that the NUSF may become an unstable source of recovery or that support may no longer be available. *In the event that the NUSF is not able to meet its funding commitments, companies*

[30] *See the Commission, on its own motion, seeking to investigate Qwest's Switched Access Charge Rates,* Application No. C-3345/NUSF-42/PI-93, Qwest Corporation's Response to Motion for Interim Relief (filed May 10, 2005) at p. 6.

[31] *See the Commission, on its own motion, seeking to investigate Qwest's Switched Access Charge Rates,* Application No. C-3345/NUSF-42/PI-93, Order Opening Docket (entered Feb. 23, 2005).

[32] *See the Commission, on its own motion, seeking to investigate Qwest's Switched Access Charge Rates,* Application No. C-3345/NUSF-42/PI-93, Order Approving Settlement and Closing Docket (entered Nov. 8, 2005).

would in that instance, be permitted to seek approval to increase intrastate access to a reasonable level.[33] (emphasis added)

In addition to Commission policy decisions, state statute also recognizes the link between implicit support in intrastate access rates and explicit NUSF support. Section 86-323(7) states that "[t]he implicit support mechanisms in intrastate access rates throughout the state may be replaced while ensuring that local service rates in all areas of the state remain affordable." This statement implies that any revenue reductions from decreases in intrastate access rates should be "replaced," presumably with NUSF and other rate increases such as to basic local exchange service. However, the principle also states that local service rates in all areas of the state should remain affordable. Therefore, in the event that explicit NUSF support is reduced, it may be necessary to increase intrastate access rates in order ensure that local service rates remain affordable. Furthermore, the principle states that implicit support mechanisms in intrastate access rates *may* be replaced, indicating that implicit support may be maintained through intrastate access rates if necessary in order to ensure that local service rates are affordable.

Federal case law also supports the proposition that implicit subsidies may be maintained in intrastate rates. The United States Court of Appeals for the Tenth Circuit was asked to rule on an argument by Qwest Communications International, Inc. ("Qwest") and SBC Communications Inc. ("SBC") that the Telecommunications Act of 1996 (the "Act") requires states to transition from implicit to explicit support

[33] *See The Commission, on its own Motion, Seeking to Conduct an Investigation of Intrastate Access Charges for Rural ILECs*, Application No. NUSF-28, Findings and Conclusions (entered Nov. 26, 2002) at ¶ 32.

mechanisms.[34] The court rejected the arguments of Qwest and SBC. The court found that in drafting the statute, Congress unambiguously imposed an explicit subsidy requirement on federal support mechanisms; however, no such requirement is expressly imposed on the states. The court stated that "[n]or did Congress expressly foreclose the possibility of the continued existence of state implicit support mechanisms that function effectively to preserve and advance universal service."[35] Therefore, Nebraska's policy of allowing, but not requiring, the replacement of implicit support mechanisms with explicit support mechanisms is supported by federal case law.

Given the combination of the Commission's policy decision allowing Qwest to raise its intrastate access rates following a reduction in NUSF support, and the Nebraska and federal statutes allowing implicit support, the Companies recommend that the Commission establish a rebuttable presumption that carriers should be allowed to increase intrastate access rates if they experience a decrease in NUSF support. As discussed above, the Commission has found that the total amount of explicit support it currently distributes through the permanent NUSF support mechanism is sufficient.[36] A rebuttable presumption that carriers will be allowed to increase intrastate access rates if their NUSF support amount is reduced would recognize that the Commission has appropriately calculated the amount of explicit support needed by each carrier given current rate structures for basic local exchange service and intrastate access service, and

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[34] *Qwest Corp. v. FCC,* 398 F.3d 1222 (10th Cir. 2005) (*"Qwest II"*).

[35] *Qwest II* at 1233.

[36] *See NUSF-26 Permanent Methodology Order* at ¶ 12.

that if such explicit support is reduced, it may be replaced by implicit support in access rates.

VI. The Commission Should Maintain The Current 12 Percent Cap On Rate-of-Return.

The Commission seeks comment on whether it should reduce the rate-of-return ("ROR") cap for carriers, and if so, what is the appropriate rate-of-return?[37] The Companies note that unlike the ROR prescribed by the Federal Communications Commission ("FCC") which is used to set rates such that carriers are guaranteed to receive the ROR on their investment and expense base (also referred to as "rate base"), the Commission's ROR cap sets the maximum amount of earnings that carriers are allowed. The ROR cap does not serve as a guarantee; in fact, carriers may earn far less than the level specified by the ROR cap. Therefore, the Companies submit that the ROR cap should remain somewhat greater than the federal ROR, because the Commission's ROR cap serves to limit earnings, not to guarantee that any given carrier will receive a certain level of earnings.

The Commission indicates that the current ROR cap is 12 percent.[38] The Companies believe that market conditions have not changed in a manner to warrant lowering the ROR cap since the Commission set it in 1999. If anything, the marketplace has become more risky for telecommunications such that it is warranted to maintain the ROR cap at such a level. Carriers face greater risks from competition, regulatory

[37] *See Order* at ¶ 5.

[38] Ibid.

decisions and technological changes.[39] For example, open proceedings at the FCC could greatly reduce the amount of revenue rural carriers receive for access charges and reciprocal compensation.[40] If revenues from these sources are reduced, such revenues may not be replaced, or they may be replaced through universal service mechanisms, which are also being examined and may be subject to reduction in the amount of support distributed.[41] Furthermore, the FCC has examined ROR in recent years and has found that lowering its ROR, which is similar to the 12 percent ROR set by the Commission, is not warranted.

The ROR is set in the interstate jurisdiction following rules contained in 47 C.F.R. § 65. The rules specify methodologies to be used to determine the weighted average cost of capital. The FCC most recently opened a docket to represcribe the authorized ROR in 1998.[42] Several parties submitting comments in that proceeding indicated that competitive, regulatory and technological risks had increased since the FCC had last prescribed the ROR, which would suggest that the FCC terminated the proceeding in 2001, maintaining the federally authorized ROR at 11.25 percent.[43]

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[39] *See for example, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Joint Direct Case and Comments of Local Exchange Carrier Associations (filed Jan. 19, 1999) at pp. 5-11.

[40] *See generally* comments and proposals submitted in *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92.

[41] *See* Public Notice, *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, FCC 04J-2 (rel. Aug. 16, 2004).

[42] *See Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, FCC 98-222 (rel. Oct. 5, 1998).

[43] *See Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-66, *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-

The FCC has also addressed the issue of the appropriate ROR to be used in determining federal universal service support amounts. In developing the Hybrid Cost Proxy Model, the FCC requested comment on the appropriate cost of capital to be used in the model to determine the cost of providing universal service.[44] The FCC found that the current 11.25 percent federal ROR is reasonable for determining the cost of providing services supported by the high-cost mechanism.[45]

Given that the FCC has examined the federally authorized 11.25 percent ROR for use in determining access rates and universal service support and found it to be reasonable, the Companies believe that it is not appropriate for the Commission to lower its ROR cap for NUSF purposes. The Commission should not arbitrarily reduce the ROR cap below 12 percent without conducting a proceeding and presenting empirical evidence to indicate that a ROR cap of less than 12 percent is appropriate. It should be noted that the cost of capital is not likely to be greatly differentiated between federal and state jurisdictions. Furthermore, as discussed above, the *Commission* imposes a *ROR cap*, while the *federal ROR* serves as a *guarantee.* Therefore, the Companies believe the ROR cap for NUSF purposes should remain at 12 percent.

The Commission also asks if carriers would make reductions in their operational expenses and/or network investments if the Commission lowers the ROR cap to 10 or 8

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166 Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304 (*"MAG Order"*) (rel. Nov. 8, 2001) at ¶¶ 206-210.

[44] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, and *Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, Further Notice of Proposed Rulemaking, FCC 99-120 (rel. May 28, 1999) at ¶¶ 237-239.

[45] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, and *Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, Tenth Report and Order, FCC 99-304 (rel. Nov. 2, 1999) at ¶ 435.

percent.[46] The Companies believe that lowering the ROR cap in such a manner would cause reductions in spending that would detrimentally impact operations and service quality, and would also cause reductions in network investments. If the Commission lowers the ROR cap, it would result in less NUSF support being received by carriers, all other factors being held constant. If carriers receive less NUSF support than they did previously, the carriers are likely to decrease the amount they invest in their networks and the amount the carriers spend on operations, as they will have less total revenue to spend.

The Commission also asks if reductions in operational expenses and/or network investments would be contrary to the purpose of federal and state universal service statutes.[47] Reducing the ROR cap would have a similar effect to alternative regulation plans such as price caps, which set ceilings on rates, in turn setting a ceiling on revenues (absent growth in demand). In considering the issue of designing an alternative regulation plan for ROR carriers, the FCC observed that:

> The design of an alternative regulation plan must also address *the incentives an alternative regulation plan gives rate-of-return carriers to reduce investment in plant and equipment, or to reduce expenditures on maintaining service quality*, in order to increase profits at the expense of maintaining adequate investment or service quality. (emphasis added)[48]

Since the inception of price cap regulation, the only carriers for which the Commission has initiated proceedings to investigate service quality complaints are the two largest ILECs in the state, both of which are price cap carriers for purposes of setting interstate

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[46] *See Order* at ¶ 5.

[47] Ibid.

[48] *See MAG Order* at ¶ 223.

access rates.[49] These examples illustrate the impact that reduced expenditures on operations and decreased network investment can have on service quality. The provision of quality services at just, reasonable and affordable rates is a principle contained in both federal and state statutes.[50] Therefore, the Companies believe that reductions in operational expenses and/or network investments, which would result from lowering the ROR cap, would be contrary to the purpose of the federal and state universal service statutes.

The Commission also asks if carriers would be able to make up for reductions in NUSF support due to a lowering of the ROR cap through other means.[51] The Companies believe that, particularly for carriers serving solely rural markets that have little or negative growth, there are no such other ways to make up for reductions. Lowering the ROR cap means that carriers will be able to earn less revenue for a given investment and expense base. Therefore, carriers do not have the option of raising rates for services if their NUSF support is decreased due to a lowering of the ROR cap. Raising rates for other services would increase revenues for those services, which as a result would increase the overall ROR. Thus, as carriers attempt to increase their total revenues by increasing rates for services, they would likely exceed the cap on revenues imposed by the lower ROR cap, and they would simply receive less NUSF support. Likewise, reducing network investment and/or operational expenses would have the same effect.

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[49] *See The Commission, on its own Motion, Seeking to Determine Whether the Retail Service Quality Provided by ALLTEL is Adequate*, Application No. C-2940, Order Opening Docket and Setting Service Quality Objectives (entered May 7, 2003) and *The Commission, on its own Motion for the General Supervision of the Progress of US West Communications, Inc.'s Plan to Improve Service to its Nebraska Customers*, Application No. C-1097, Order Opening Docket (entered Aug. 16, 1994).

[50] *See* Neb. Revised Statutes § 86-323(1) and 47 U.S.C. § 254(b)(1).

[51] *See Order* at ¶ 5.

Reducing these expenditures would lower the amount of total revenue for which a carrier would be eligible. Either result is undesirable, contrary to the NUSF's goals and leads to a type of "death spiral" for companies serving rural areas. Therefore, lowering these expenditures would not allow a carrier to receive additional NUSF support. Clearly, carriers would have no means at their disposal to make up for decreased NUSF support due to a lowering of the ROR cap to a level such as 10 or 8 percent.

VII. The Commission Should Not Modify The Manner In Which It Calculates Earnings.

The Commission seeks comment on whether it should modify the manner in which it calculates earnings in order to effectuate reductions in the amount of NUSF support distributed.[52] The Companies do not believe that a change in the manner in which the Commission calculates earnings would necessarily result in distributing less NUSF support unless the Commission also reduced the amount of support distributed through the OER. To the extent that the Commission adopted a new manner of calculating earnings that generally reduced the amount of NUSF support for which carriers are eligible, without a reduction in the amount of OER distributed, it is possible that some carriers currently receiving OER would have their ROR reduced even further, resulting in such carriers receiving even more funds through OER than at present. Therefore, without setting a cap on the amount of funds distributed through OER, changing the manner in which earnings are calculated may simply result in a redistribution of NUSF support among carriers, and may not reduce the total amount of support distributed.

[52] Id. at ¶ 6.

Modifying the manner in which the Commission calculates earnings in order to reduce the amount of NUSF support distributed would also serve to reduce incentives for investment. If the manner in which earnings are calculated is changed such that carriers generally receive reduced amounts of support, this change would not have been anticipated by carriers, and in effect makes the amount of support received less predictable. If carriers are not able to accurately predict the amount of support they will receive, they are less likely to make network investments which would increase their need for universal service support.

VIII. The Commission Should Maintain The Current $17.50 Benchmark For Basic Local Exchange Service.

The Commission requests comment on whether it should increase the local rate benchmark to $18.50 from $17.50.[53] The Commission states that carriers "would be permitted to, but not required, to charge $18.50 for basic local exchange service."[54] The Companies do not believe that this is an appropriate solution.

The existing local rate benchmark of $17.50 was developed through careful consideration by the Nebraska Universal Service Task Force, created by the Commission in Docket C-1176 in early 1996, and adopted by the Commission in 1999.[55] The Commission then continued the local rate benchmark of $17.50 after almost four years of comments and hearings in the NUSF-26 proceeding.[56] The prior determinations by the Commission were correct and should not be disturbed at this time.

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[53] Id. at ¶ 8.

[54] Ibid.

[55] *See C-1628 Order* at p. 5.

[56] *See NUSF-26 Permanent Methodology Order* at p. 10.

The Companies believe the Commission should recognize the pending intercarrier compensation changes that may ultimately take place at the FCC before making any changes to the benchmark rate. It is important to note that the majority of the proposals being considered by the FCC contain increases in the federal subscriber line charge ("SLC") caps.[57] The Commission must be mindful of the potential burden that Nebraska consumers, especially those in rural areas, would face if the Commission increases the local rate benchmark and the FCC increases the federal SLC.

Nebraska's current minimum monthly local service charges for residential customers served by rural telephone companies, including the federal subscriber line charge and all federal and state taxes and surcharges are $27.99 per month.[58] This compares with the current national average residential monthly local service charges of $24.31 per month.[59] Furthermore, while Nebraska's minimum monthly local service charges for residential customers are well above the national average, per capita personal income in rural areas of Nebraska is well below the national average. For example, in 2003, per capita personal income for the United States was $30,179, while it was only $26,295 for non-metropolitan areas in Nebraska.[60] In addition, a county-by-county

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[57] *See generally* comments and proposals submitted in *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92.

[58] This total is the sum of the charges for basic local exchange service ($17.50), the federal SLC ($6.50), the 911 surcharge ($0.50), the TRS surcharge ($0.07), the NUSF surcharge (5.75% of the charge for basic local service and the SLC), the state sales tax (5.5 % of the charge for basic local service and the SLC) and the federal excise tax (3% of the charge for basic local service and the SLC). The total would be less for non-rural carriers in Nebraska, which charge a SLC of less than $6.50.

[59] *See* Universal Service Monitoring Report 2005, CC Docket No. 98-202, Prepared by Federal and State Staff for the Federal-State Joint Board on Universal Service in CC Docket No. 96-45 (rel. Dec. 29, 2005) at Table 7.6.

[60] *See* U.S. Department of Commerce, Bureau of Economic Analysis, Regional Accounts Data, Local Area Personal Income at http://www.bea.gov/bea/regional/reis/default.cfm?series=naics.

examination of per capita income reveals that some counties with low per capita incomes also have below average poverty rates. Therefore, households in these areas would not likely qualify for Lifeline assistance. Instituting further increases in the local rate benchmark could very well make local service unaffordable for such households.

Based on the foregoing reasons, the Companies recommend that the Commission maintain the local rate benchmark at $17.50 per line per month. The Companies believe this benchmark rate should continue at least for the transition period for the permanent NUSF support mechanism. If the Commission, however, finds that some form of local rate benchmark adjustment is necessary prior to said expiration, the Companies recommend the Commission refrain until the FCC acts on its pending intercarrier compensation docket. Once the FCC has acted, the Commission could then open a docket to examine the proper amount of any local rate benchmark increase and whether such an increase should be optional or mandatory.

IX. Carriers Are Unlikely To Be Able To Increase Rates For Broadband And Vertical Services In Order To Cover Reductions In NUSF Support.

The Commission asks if it should take into consideration a carrier's ability to adjust rates for broadband services or vertical services when making a decision to reduce NUSF support amounts.[61] The Companies believe it is highly unlikely that carriers could adjust rates for broadband and/or vertical services in order to compensate for any reductions in NUSF support amounts.

Carriers are unlikely to increase rates for broadband and/or vertical services because demand for these services is price elastic. This means that as prices for these services are increased, the percentage decrease in demand may be greater than the

[61] *See Order* at ¶ 10.

percentage increase in price, resulting in a lower, rather than greater, total revenue provided by the service following the price increase. Therefore, increasing the price for such services may not increase the total revenue provided by these services.

The Commission also asks if there is a disincentive to change rates for broadband services and vertical services in competitive markets.[62] To the extent that competitors exist for these services in any given market, there is clearly a disincentive for carriers to raise the price of such services, given the price elastic nature of demand for the services explained above. In fact, the existence of a competitive alternative for a service would likely cause a greater loss of revenue due to a price increase, as instead of some consumers simply discontinuing a service altogether, many consumers may switch to an alternative service provider offering a lower price.

X. The Transition Period In the NUSF-26 Permanent Methodology Order Should Remain In Effect.

The Commission seeks comment on the timing of proposed modifications to the NUSF support mechanism.[63] As discussed above, the *NUSF-26 Permanent Methodology Order* provided for a 5-year transition period to the permanent model.[64] Additionally, the Commission encouraged carriers to rely upon the *NUSF-26 Permanent Methodology Order* and make investment decisions based upon the permanent mechanism.[65]

Relying upon the time frames set forth in the *NUSF-26 Permanent Methodology Order* and the Commission policy to encourage investments in the carriers' facilities

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[62] Ibid.

[63] *See Order* at ¶ 13.

[64] *See NUSF-26 Permanent Methodology Order* at ¶ 62.

[65] Id. at ¶ 76.

means that any significant change to the permanent mechanism should be transitioned into use over a time frame that recognizes the prior orders of the Commission and a carrier's reasonable expectation to rely upon these orders for a reasonable period of time. Any type of flash cut transition to a model or funding level different than contained in the *NUSF-26 Permanent Methodology Order* will not allow the carriers an opportunity to make adjustments in current planning or capital plans and cause undue hardship to customers.

In short, the Companies believe that *no modification* to the permanent model or funding level change should be instituted at least until the current transition period has concluded.

XI. The Commission Should Examine The Need To Raise The NUSF Surcharge.

While these comments address the questions posed by the Commission in the Order, the Companies believe that the process should be sequenced such that a support distribution mechanism is selected prior to setting the NUSF surcharge, so that the surcharge amount can be set to collect funds sufficient to distribute the necessary amount as determined by the support distribution mechanism. Such a process has been followed by the FCC in determining the appropriate federal universal service surcharge. In other words, the FCC clearly establishes the individual support mechanisms and the amount of support necessary to fund each support mechanism, and then compares the total amount of support necessary to fund the mechanisms to the assessable base of interstate telecommunications services revenues in order to determine a percentage surcharge. This process is conducted on a quarterly basis in order to more closely match the percentage surcharge with the total amount of funds needed. In fact, in the order setting the surcharge at 5.75 percent, the Commission indicated that it is able to adjust the surcharge rate on an emergency basis if needed.[66] The Companies believe that after examining potential modifications to the permanent support mechanism, the Commission may need to increase the surcharge rate in order to meet statutory principles for universal service contained in the Act and the NTUSF Act.

XII. Conclusion

For the forgoing reasons, the Companies recommend that the Commission not make changes to the permanent NUSF support mechanism, at least until the 5-year duration of the transitional mechanisms has expired. However, if the Commission nonetheless implements changes to the permanent NUSF support mechanism to reduce the total amount of support distributed, the Companies recommend that the Commission gradually reduce the amount of support paid through the per-line backstop and OER transitional mechanisms. Furthermore, if the Commission implements changes that cause reductions to a carrier's NUSF support, the Commission should establish a rebuttable presumption that a carrier is entitled to raise its intrastate access rates in order to recover any revenues lost due to decreases in NUSF support.

DATED: April 14, 2006.

[66] *See The Commission, on its own motion, seeking to determine the level of the fund necessary to carry out the Nebraska Telecommunications Universal Service Fund Act to be effective fiscal year beginning July 1, 1999*, Application No. NUSF-4, Order Setting Surcharge (entered July 6, 2005) at p. 2.

Respectfully submitted,

THE RURAL INDEPENDENT COMPANIES

Arlington Telephone Company,
The Blair Telephone Company,
Cambridge Telephone Company,
Clarks Telecommunications Co.,
Consolidated Telco Inc.,
Consolidated Telecom, Inc.,
Consolidated Telephone Company,
Eastern Nebraska Telephone Company,
Great Plains Communications, Inc.,
Hartington Telecommunications Co., Inc,
Hershey Cooperative Telephone Co.,
K&M Telephone Company, Inc.,
The Nebraska Central Telephone Company,
Northeast Nebraska Telephone Company,
Rock County Telephone Company,
Stanton Telecom Inc., and
Three River Telco

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THEIR ATTORNEYS

CERTIFICATE OF SERVICE

I hereby certify that on the 14th day of April, 2006, the original and five (5) paper copies, together with an electronic copy, of the foregoing **Comments of the Rural Independent Companies** were served upon Andy S. Pollock, Executive Director of the Commission, by hand delivery.

James A. Overcash